STATE OF MICHIGAN

MICHIGAN SUPREME COURT

J & J FARMER LEASING, INC., FARMER BROTHERS TRUCKING CO., INC. CALVIN ORANGE RICKARD, JR., and JAMES W. RILEY, as Personal Representative of the ESTATE OF SHARYN ANN RILEY, Deceased, OK

Plaintiffs-Appellees,

v

CITIZENS INSURANCE COMPANY OF AMERICA,

Defendant-Appellant.
_______________________________________/

S. Ct. No.
Court of Appeals No. 239069 Opn 2/12/04
L.C. No. 96-3742 NO

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D. Swartz

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NOTICE OF HEARING

APPLICATION FOR LEAVE TO APPEAL

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STATEMENT CONCERNING COMPLAINED-OF OPINION AND SETTING FORTH REQUESTED RELIEF

Pursuant to MCR 7.302, defendant-appellant Citizens Insurance Company of America (hereinafter "Citizens") seeks this Court's review of the Michigan Court of Appeals' February 12, 2004, opinion. A copy of the opinion is submitted as Exhibit A.

This is a bad-faith failure to settle case arising out of a judgment entered against Citizens' insureds in an amount exceeding policy limits. After entry of the judgment, the underlying plaintiff entered into an agreement not to execute whereby the underlying plaintiff forever released Citizens' insureds, agreeing never to collect the over-limits amount from them. Citizens moved for summary disposition, arguing that a bad-faith failure to settle claim cannot be established as a matter of law because, based on the release, its insureds are no longer exposed to pecuniary loss. An insured that is insulated from sustaining pecuniary loss cannot recover against its insurer in a bad-faith failure to settle action because, under Michigan law, recovery in such an action is limited to the insured's actual or potential pecuniary loss. *Frankenmuth v Keeley,* 433 Mich 525, 447 NW2d 691 (1989), *rev'd on reh'g*, 436 Mich 372 (1990).

The Court of Appeals granted leave to appeal from the trial court's denial of summary disposition. In its subsequent opinion, the Court of Appeals affirmed, albeit using a different analysis than that of the trial court (the trial court found that the agreement not to execute did not extinguish the judgment, but did not explain why that was relevant). The Court of Appeals acknowledged that the agreement indisputably released Citizens' insureds from any obligation to satisfy the underlying judgment. The court also acknowledged that Citizens' position represents "an arguably correct interpretation of how *Keeley* might be applied to the circumstances presented in this case . . . ." Nevertheless, the Court of Appeals affirmed, reasoning that Citizens' position is inconsistent with what it perceived to be the "intent" of *Keeley.*

As set forth in the argument section below, the Court of Appeals erred in so concluding. The Court of Appeals' opinion cannot be reconciled with *Keeley*, whether the focus is on the actual holding of *Keeley* or on the intent made manifest by the Court's discussion leading up to that holding. Accordingly, review by this Court is warranted under MCR 7.302(B)(5).

This appeal also presents legal principles of major significance to Michigan jurisprudence, and, thus, is properly considered under MCR 7.302(B)(3). The author of *Keeley*, Justice Levin, warned that if this Court adopted the view that ultimately became the dissent in that case, "this Court will for the first time have departed from the principle of confining the damages for breach of contract by an insurer to the economic loss suffered by the promisee" because it would allow recovery in a bad-faith failure to settle case "without proof that [the insured] incurred economic loss." The Court of Appeals' published opinion represents such a departure: under the Court of Appeals' opinion, a plaintiff in a bad-faith failure to settle case against an insurer need not show any potential for pecuniary loss by the insured in order to recover against the insurer. Simply put, the Court of Appeals' opinion allows an award against an insurer in a bad-faith failure to settle case that cannot fairly be considered anything other than punitive.

Moreover, there is nothing in the Court of Appeals' opinion that would prevent an insured and an underlying plaintiff from now stipulating to a judgment in whatever amount they deem appropriate, then seeking collection from the insurer of that amount. Indeed, such activity appears to be plainly allowed, given the Court of Appeals' explicit finding that an insured's maneuverings to avoid exposure to a judgment do not affect a bad-faith failure to settle claim against its insurer.

In addition to representing a sweeping change in Michigan law in this area, the Court of Appeals' opinion is contrary to the holdings of a number of cases from other jurisdictions that have directly addressed the same issue, and held that a release of or a covenant not to execute against an insured with respect to an over-limits judgment precludes collection from the insurer under a theory of bad-faith failure to settle. The Court of Appeals' opinion makes no mention of these cases despite Citizens' reliance upon them in its briefs. In fact, the Court of Appeals' opinion cites no authority from any jurisdiction to support its rationale.

Because the Court of Appeals' opinion is erroneous, conflicts with a decision from this Court (and other courts), and raises issues of major significance to the state's jurisprudence, Citizens respectfully urges this Court to take action on this application. As for the specific relief requested, Citizens first and foremost asks that this Court peremptorily reverse the Court of Appeals' opinion, and remand the matter to the trial court for entry of summary disposition in favor of Citizens. Failing that, Citizens asks that the Court grant leave to appeal the complained-of opinion.

STATEMENT OF THE QUESTION PRESENTED

Should this Court review or peremptorily reverse the Court of Appeals' published opinion affirming the denial of summary disposition of a claim alleging bad-faith failure to settle by Citizens, where Citizens' insured is insulated from pecuniary loss because of a release executed by the underlying plaintiff, given this Court's holding in *Frankenmuth v Keeley,* 433 Mich 525, 447 NW2d 691 (1989), *rev'd on reh'g*, 436 Mich 372 (1990), that a bad-faith failure to settle claim is based in contract and, thus, a plaintiff's recovery is limited to pecuniary loss suffered by or actually collectable from the insured?

Defendant-Appellant Citizens answers: "NO."
Plaintiffs-Appellees would answer: "YES."
The court of appeals answered: "YES."
The trial court answered: "YES."

STATEMENT OF FACTS

A. Substantive facts

This is a bad-faith failure to settle case. The complaint was filed against Citizens on November 1, 1996 by J&J Farmer Leasing, Inc. ("J&J Farmer"), Farmer Brothers Trucking Co. ("Farmer Bros."), Calvin Orange Rickard, Jr. ("Rickard")[1], and James W. Riley, as personal representative of the estate of Sharyn Ann Riley, deceased ("Riley estate" or "estate").

The facts material to the issue on appeal are undisputed. Citizens provided liability insurance to J&J Farmer, which included coverage for liability arising out of the vehicle driven by its employee Rickard in the underlying accident. In the underlying action, a wrongful death lawsuit, the Farmer entities were sued by the Riley estate for the death of Sharyn Riley caused when Rickard crossed the center line and collided with Ms. Riley's automobile on November 15, 1994. The wrongful death lawsuit was filed on or about January 11, 1995. After receiving the wrongful death lawsuit from J&J Farmer, Citizens honored its duty to defend by retaining Judith Moskus of the Garan, Lucow firm as defense counsel for the Farmer entities.

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[1] J&J Farmer, Farmer Bros., and Rickard are collectively referred to herein as Citizens' insureds, or as "the Farmer entities."

Shortly after the wrongful death lawsuit was filed, Citizens made an offer of $500,000 to settle the estate's claim.[2] The estate, on the other hand, initially demanded policy limits of $750,000, but two weeks later changed its demand to policy limits plus an unspecified sum in excess of the policy limits to be paid by J&J Farmer/Farmer Bros. directly.

Throughout the pendency of the underlying wrongful death case, there was a dispute concerning the amount of damages suffered as a result of Ms. Riley's death in the form of economic damages (wage loss) and non-economic damages (loss of society and companionship). There was also an issue as to whether Ms. Riley was comparatively negligent. Eventually, the wrongful death case was scheduled for Mediation in January 1996. As part of the mediation, the estate, through its counsel, Robert Logeman, specifically requested that the Citizens insurance policy limits not be divulged to the mediators so as to get a "true" valuation of the case. The case ultimately mediated in favor of the estate for $950,000. As a result of the mediation award, Citizens filed an Offer to Stipulate to Judgment for its policy limits of $750,000 on or about February 21, 1996.

Several settlement conferences were subsequently ordered by Judge Donald Shelton. During the first settlement conference, on March 4, 1996, the estate represented to the trial court that the estate wanted to conduct a discovery of assets deposition of J&J Farmer to determine if there were any assets of J&J Farmer above the Citizens policy limits of $750,000. The settlement conference was adjourned to permit the assets deposition. Additional settlement

[2] Facts concerning Citizens' offers and other conduct, while material to this action generally, are not particularly significant for purposes of this application. They are briefly set forth nonetheless in order to give the Court the complete context in which the more pertinent events, those involving the agreement to release the Farmer entities, transpired. Record references and exhibits supporting factual statements pertaining to the settlement discussions are omitted but are part of the trial court record.

conferences were held on March 18, April 22, and May 13, 1996. During these conferences, the trial court was informed by various Citizens representatives that Citizens was still offering its policy limits to settle the wrongful death lawsuit consistent with its earlier Offer to Stipulate to Judgment for $750,000. During these settlement conferences, the estate informed the court that the estate's formal demand to settle the claim was policy limits plus interest, approximately $825,000. Citizens, however, would not commit to paying interest on a settlement offer as the plain language of its policy only required the payment of interest upon the entry of judgment by a court.

When it became clear to Citizens Vice President of Claims, Roger Gardner, during the May 13 conference that the parties were at a stalemate, Citizens proposed a compromise to resolve the dispute. Specifically, Citizens offered to pay an additional $25,000 if its insured, J&J Farmer, contributed $25,000 to the settlement and the estate agreed to reduce its demand by $25,000 for a total settlement package of $800,000. J&J Farmer refused to contribute any money toward a settlement with the estate. The parties left the May 13 settlement conference with no settlement and a directive from Judge Shelton to be prepared for trial in two weeks. Citizens' offer of policy limits remained on the table throughout trial.

After a three-day trial, a jury verdict was entered in favor of the estate. A judgment for approximately $3.2 million was subsequently entered by the trial court on July 24, 1996. As a result, pursuant to the terms of its policy, Citizens paid the estate its policy limits of $750,000 plus interest, costs, mediation sanctions and attorney fees, for a total of over $950,000. Plaintiff James Riley, as personal representative of the estate, executed a Partial Satisfaction of Judgment on September 13, 1996, acknowledging that Citizens fulfilled its financial obligations under the policy. (Partial Satisfaction of Judgment submitted as Exhibit B).

Shortly after the judgment was entered, in August 1996, the estate executed an Agreement with the Farmer entities whereby the estate agreed to "forever forebear" collection of the amount of the judgment in excess of the Citizens policy limits from the Farmer Bros. entities in exchange for a lien on any proceeds from a failure to settle action against Citizens. Specifically, the Agreement provides in pertinent part:

> That the Plaintiff [Riley estate] agrees to **forever forebear** any action to collect any monies to satisfy the unpaid portions of the Judgment that the Plaintiff has against the Defendants [J&J Farmer, Farmer Bros., Rickard], in exchange for which the Defendants do hereby grant to the Plaintiff a lien on any proceeds of any bad faith claim, negligence claim, contract claim or intentional tort claim as set forth herein. (Emphasis added).

(Agreement submitted as Exhibit C, ¶ 10(b)). The Agreement also provided, as "further consideration of the forbearance of the Plaintiff's right to collect monies to satisfy the Judgment," for a division of any sums collected from Citizens among the estate, the attorneys for the estate, and the attorney for the Farmer entities (Exhibit C, ¶ 10(c)). Also, the Farmer entities agreed not to appeal the judgment, and to direct Citizens not to appeal it (Exhibit C, ¶ 10(h)). This lawsuit against Citizens for its alleged bad-faith failure to settle was filed in November 1996.[3]

---

[3]At the time the estate agreed to forever forbear collection of the amount in excess of the policy, no assignment was made of the Farmer entities' rights vis-à-vis its insurance policy with Citizens. In fact, not until after Citizens filed its first motion for summary disposition was there any assignment of the Farmer entities' rights. On November 26, 1997, the day before Citizens' motion was heard, and more than a year after the complaint was filed, the Farmer entities purported to assign their right to proceed with a bad-faith breach claim to the estate. The bad-faith claim, however, had long ago been released by the estate.

B. Material proceedings

The Complaint in this case was filed on November 1, 1996. Citizens filed its original motion for summary disposition on September 17, 1997. In its motion, Citizens argued that it was entitled to dismissal based on the estate's agreement to forever forbear any action to collect against Citizens' insureds. The trial court did not address this issue, since it granted Citizens' motion on the alternative grounds that Citizens could not be deemed to have failed to settle the estate's wrongful death suit in bad faith because it offered its policy limits prior to trial. In an opinion dated October 22, 1999, the Court of Appeals reversed the trial court's grant of summary disposition on that basis and remanded for further proceedings.

On remand, Citizens again moved for summary disposition, on June 21, 2001, asserting that the estate's agreement to forever forbear collection against the insureds of the excess portion of the underlying judgment extinguished Citizens' liability. Plaintiffs filed a response on August 7, 2001. Citizens filed a reply on August 14, 2001. The motion was heard before the Washtenaw County Circuit Court, Honorable David S. Schwartz, on August 15, 2001, at which time Judge Schwartz instructed the parties to provide additional briefs on the issue.

Pursuant to the trial court's instructions, Citizens filed a supplemental brief in support of its motion on September 14, 2001. Plaintiffs filed a supplemental brief in opposition to the motion on October 4, 2001. Citizens filed a reply on October 19, 2001. Plaintiffs filed a surreply on October 26, 2001.

The motion was argued to the trial judge again on January 2, 2002. The trial court denied the motion, indicating that a covenant not to execute "does not necessarily operate to extinguish the underlying judgment" and that "provision 10(f) of the agreement between plaintiff and J&J Farmer states conditions under which plaintiff is permitted to take action to collect the unpaid portion of the judgment against J&J Farmer."[4] (1/2/02 Tr, submitted as Exhibit H, p 15). Counsel for Citizens understood that ruling as referencing the possibility of the covenant being voided by a lack of cooperation with the estate by the insureds under provision 10(f), which was raised by plaintiffs in the second round of briefing as a possible scenario under which the agreement to forever forbear from execution might lose its effect. Counsel asked if the court's ruling would be deemed "without prejudice", since the cooperation requirements in the agreement between the estate and the insureds would by definition be fulfilled by the close of plaintiffs' proofs (and since there had been no suggestion to that point that any cooperation requirement had been breached). The trial court answered in the negative, merely stating without elaboration that there are "aspects that . . . the plaintiffs argued that don't rely on anything yet to be determined." (1/2/02 Tr, p 16).

An order reflecting the court's denial of Citizens' motion was entered on January 2, 2002. Citizens filed a timely application for leave to appeal on January 23, 2002. Plaintiffs filed an answer to Citizens' application for leave to appeal. On March 21, 2002, the Court of Appeals (Judges Saad, Cavanagh, and Fitzgerald) granted leave to appeal (Order granting leave submitted

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[4] Provision 10(f) states:

> In the event that any of the Defendants shall fail to: (1) execute pleadings necessary to prosecute the lawsuit; (2) attend meetings with counsel; (3) comply with discovery; or (4) attend evidentiary hearing or trial as needed in the discretion of counsel, the Plaintiff shall notify the offending party in writing of its breach of this agreement, specifying the act or omission which constitutes the alleged breach and the means by which the offending party shall cure the breach. Thereafter, the offending party shall have fifteen (15) days in which to perform the specified corrective action (eg. supply documents, answer interrogatories, or attend a desposition [sic] or meeting). If the offending party fails to timely cure its breach or its breach is not capable of being cured (i.e. the lawsuit is dismissed as a result of the offending party's conduct), then the Plaintiff may declare this Agreement null and void as to the offending party, only, but not as to any other Defendant. In that event, and that event only, is the Plaintiff permitted to take action to collect the unpaid portion of the Judgment from the offending party.

as Exhibit D). Following briefing and oral argument, the Court of Appeals (Judges Hoekstra, Sawyer, and Murray) issued its opinion for publication on February 12, 2004.

The Court of Appeals agreed that the Farmer entities were indisputably released from any obligation to pay the underlying judgment (Slip Op., p 7). The court also acknowledged "the straightforward and compelling logic of Citizens' argument," and agreed that Citizens' position represents "an arguably correct interpretation of how *Keeley* might be applied to the circumstances presented in this case …." (Slip Op., p 8). The court nevertheless rejected Citizens' argument, reasoning as follows:

> The principle [sic] reason we decline to agree with Citizens' interpretation of the holding of *Keeley* and its application to the facts of the present case is that it would turn what our Supreme Court intended to be a shield into a sword. In *Keeley* our Supreme Court provided a shield to guard insurers found liable for bad-faith failure to settle from paying the judgment balance that the insured could not have paid fully. Here, Citizens attempts to turn the shield provided in *Keeley* into a sword to escape any payment on the excess judgment, despite the insured's ability to pay some or all of it, merely because the insured assigned the bad-faith claim to the judgment holder and in exchange obtain relief from paying the underlying judgment. We believe that the application of the holding of *Keeley* in the manner advanced by Citizens is contrary to the purpose and intent of Justice Levin's dissent.

(Slip Op., pp 8-9 [footnote omitted]). The court then quoted a portion of Justice Levin's opinion in *Keeley I* that ultimately became this Court's holding, opined briefly as to the intent behind it, and reasoned:

> Citizens seeks to limit collection to "what is or would actually be collectable from the insured," *Keeley I, supra*, without regard to the Court's analysis in arriving at this conclusion. Read in its entirety, the *Keeley* decision is concerned with how much is or would be collectable from the insured to limit the insurer's liability in a fair manner. In light of the public policy extended by the Supreme Court, we are not persuaded by Citizens' vision of eluding payment regardless of bad faith failure to settle where the insured has taken measures to protect itself with regards to what it deems its insurer's bad faith failure to settle. We cannot conclude,

> as Citizens suggests, that the fact that the Farmer parties have entered an agreement to prevent financial ruin they resultantly caused the forfeiture of any recovery from Citizens for its alleged bad faith. Rather, we believe that *Keeley* requires an insurer found liable for bad-faith failure to settle to pay the excess judgment to the extent the insurer would have been able to pay, regardless of the insured's obtainment of a release. To hold otherwise would be to evade the intent of our Supreme Court and cause a windfall for the insurer on the basis of the insured's savvy in saving itself from potential financial ruin, which needed to be done only as a result of the insurer's alleged bad faith in causing an excess judgment against its insured. . . An insured should not be penalized for devising or taking advantage of a method of avoiding financial loss allegedly flowing from the bad faith of its insurer, nor should an insurer benefit from its insured's maneuverings to protect itself.

(Slip Op., p 9).

The Court of Appeals concluded its opinion by expressing its belief that this Court "did not, nor did it intend to, preclude recovery against an insurer for bad faith failure to settle simply because the insured takes steps to protect itself from an excess judgment that it believes resulted from its insurer's bad faith failure to settle." (Slip Op, p 10). The court instructed that, should the trial court determine that Citizens engaged in a bad-faith failure to settle, it "shall preclude 'collection on the judgment from Citizens beyond what is or would actually be collectable from the Farmer Parties.'" (Slip Op, p 10 (quoting *Keeley I* at 565)).

The instant application followed. Additional facts are set forth in the argument section below as appropriate.

<u>STANDARD FOR GRANTING LEAVE TO APPEAL</u>

The standard for granting leave to appeal is set forth in MCR 7.302. That rule provides the following grounds for granting leave to appeal:

> (1) the issue involves a substantial question as to the validity of a legislative act;

> (2) the issue has significant public interest and the case is one by or against the state or one of its agencies or subdivisions or by or against an officer of the state or one of its agencies or subdivisions in the officer's official capacity;
>
> (3) the issue involves legal principles of major significance to the state's jurisprudence;
>
> (4) in an appeal before decision by the Court of Appeals,
>
> (a) delay in final adjudication is likely to cause substantial harm, or
>
> (b) the appeal is from a ruling that a provision of the Michigan Constitution, a Michigan Statute, a rule or regulation included in the Michigan Administrative Code, or any other action of the legislative or executive branch of state government is invalid;
>
> (5) in an appeal from a decision of the Court of Appeals, the decision is clearly erroneous and will cause material injustice or the decision conflicts with a Supreme Court decision or another decision of the Court of Appeals; or
>
> (6) in an appeal from the Attorney Discipline Board, the decision is erroneous and will cause material injustice.

The issues presented here require this Court's review under ¶ (5) because the Court of Appeals' opinion conflicts with a decision of this Court, as set forth in Argument sections A. and B. Review is also required under ¶ (3), because the Court of Appeals' opinion implicates legal principles of major significance to the state's jurisprudence, as set forth specifically in Argument section D.

STANDARD OF REVIEW IN SUBSTANTIVE APPEAL

This Court reviews a trial court's denial of summary disposition *de novo*. *Singerman v Municipal Services Bureau, Inc*, 455 Mich 135; 565 NW2d 383 (1997).

ARGUMENT

THIS COURT SHOULD REVIEW OR PEREMPTORILY REVERSE THE COURT OF APPEALS' PUBLISHED OPINION AFFIRMING THE DENIAL OF SUMMARY DISPOSITION OF A CLAIM ALLEGING BAD-FAITH FAILURE TO SETTLE BY CITIZENS, WHERE CITIZENS' INSURED IS INSULATED FROM PECUNIARY LOSS BECAUSE OF A RELEASE EXECUTED BY THE UNDERLYING PLAINTIFF, GIVEN THIS COURT'S HOLDING IN *FRANKENMUTH V KEELEY*, 433 MICH 525, 447 NW2D 691 (1989), *REV'D ON REH'G*, 436 MICH 372 (1990), THAT A BAD-FAITH FAILURE TO SETTLE CLAIM IS BASED IN CONTRACT AND, THUS, A PLAINTIFF'S RECOVERY IS LIMITED TO PECUNIARY LOSS SUFFERED BY OR ACTUALLY COLLECTABLE FROM THE INSURED

A. *Keeley* establishes that where, as here, an insured is insulated against suffering pecuniary loss due to an over-limits judgment, there can be no claim of bad-faith failure to settle because recovery on such a claim is limited to pecuniary loss suffered by or actually collectable from the insured.

The sole claim asserted in this action is that of bad-faith failure to settle. Although there have been relatively few cases from this Court and the Michigan Court of Appeals in this area, this Court's opinion in *Frankenmuth Mut Ins Co v Keeley*, 433 Mich 525; 447 NW2d 691 (1989), *rev'd on reh'g*, 436 Mich 372 (1990)[5], established, in meticulous fashion, several important guidelines that govern this case. The issue in *Keeley* was the extent to which recovery could be had for a bad-faith failure to settle on the part of Keeley's insurer, Frankenmuth.

Keeley's liability policy with Frankenmuth had a policy limit of $50,000. Frankenmuth declined to settle the underlying claim for that amount, and Keeley was ultimately found liable in the underlying action in the amount of $250,000. The trial court ruled that Frankenmuth had

[5] Citizens will follow the Court of Appeals' lead and refer to the original opinion, at 433 Mich 525, as *Keeley I*, the opinion on rehearing, at 436 Mich 372, as *Keeley II*, and this Court's decision as a whole as *Keeley*.

breached its duty to settle in bad faith, and awarded damages to Keeley in the amount that the injured party would have been able to recover from Keeley without regard to insurance coverage, i.e., the amount of Keeley's assets not exempt from legal process—as opposed to the entire amount over the policy limit. *Keeley I,* at 433 Mich 532. The Court of Appeals affirmed and remanded for a determination of the extent of Keeley's assets not exempt from legal process and for entry of judgment against Frankenmuth in that amount. *Id.*

On leave granted, a majority of this Court initially reversed, adopting Justice Archer's opinion that when an insurer exhibits bad faith in failing to settle a claim on behalf of its insured, the insurer is liable for any excess judgment without regard to whether the insured has the capacity to pay it. *Id.* at 544. Thus, the Court adopted the judgment rule approach and rejected the pre-payment rule.[6]

Justice Levin issued a lengthy dissenting opinion, which the Court ultimately adopted as its own on rehearing. *Keeley II,* 436 Mich 372. Justice Levin agreed that the judgment rule is generally a better approach than the prepayment rule, reasoning that an insured should not be required to sell assets or borrow money to pay a judgment in order to maintain an action against the insurer for bad faith. *Keeley I,* at 433 Mich 553-554. Justice Levin nonetheless dissented because he determined that Justice Archer's opinion represented a departure from longstanding Michigan law limiting recovery in a contract action to pecuniary loss suffered by the plaintiff.

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[6] The older pre-payment rule provides that an insurer may be held liable in a failure to settle case only if part or all of the judgment has been paid by the insured. The judgment rule requires an insurer to pay the over-limits judgment in instances of bad faith without such initial payment by the insured. *Keeley I,* at 433 Mich 535.

Justice Levin began by expressing agreement with, and quoted from, a decision by the New York Court of Appeals as follows:

> We agree with Chief Judge Fuld of the New York Court of Appeals who said:
>
> > "I do not suggest – although there are a number of decisions so holding – that an insured must pay the judgment before he, or another on his behalf, is able to proceed against a bad faith insurer. *However, there must be some showing that he has been damaged.* In the case before us, there is not the slightest evidence, or even intimation, that the insured was harmed by the judgment, that he had any assets which were imperiled or that either his reputation or credit was impaired.
> >
> > "In short, the complaint in this case should be dismissed not only because there is no evidence that the insurer acted in bad faith, but also because there is no proof that the insured suffered any damage." (emphasis added in *Keeley*).

Keeley I, at 433 Mich 554 (Levin dissenting) (quoting *Gordon v Nationwide Mut Ins Co,* 30 NY2d 427, 441; 285 NE2d 849 (1972)).

Justice Levin went on to emphasize, citing *Keeton & Widiss,* Insurance Law, § 7.8(i)(1), pp 899-900, that "third party claimants are not in a position to assert that they were harmed as a result of the insurer's conduct in regard to having not settled the tort claim. *The insurer's duty was to the insured, not to the claimant.*" *Keeley I*, at 433 Mich 555 (emphasis added by Justice Levin).[7] As Justice Levin recognized, although a third party claimant deserves further compensation (by virtue of the underlying judgment), the theoretical justification for imposing

[7] See also *Id* at 561, citing *Commercial Union Ins Co v Medical Protective Co*, 426 Mich 109, 126; 393 NW2d 479 (1986), which held that a primary insurer does not owe a duty to an excess insurer to act in good faith to settle a claim. Rather, a duty in the bad-faith failure to settle context is owed only to an insurer's insured. *Id.*

liability on the insurer in a bad-faith failure to settle claim is harm to the insured, not harm to the underlying claimant. *Id.*

Justice Levin's concern with the majority opinion was that it would require the insurer to pay out on a bad-faith failure to settle claim "without any evidence or finding that [the insured] suffered pecuniary loss in that amount." *Id.* Because Michigan holds that actions for bad-faith failure to settle sound in contract, not in tort, *id.* at 555, such an award against an insurer would violate the well-settled principle that "contract damages seek to place the aggrieved party in the same *economic* position he would have been in had the contract been performed." *Id.* at 555 (emphasis in original). See also, *id.* at 557-558, including fn 23. Justice Levin further stressed that in Michigan, in contrast with a number of other states, damages in contract (as well as in tort) are compensatory, not punitive; contract damages are "measured by the loss to the promisee, not the loss or gain to some other person." Consequently, "There should not be any concern about a so-called windfall to an insurer." *Id.* at 559.

After citing these principles governing damages in contract claims, Justice Levin astutely recognized:

> Although not expressly stated in the lead opinion, since the over $600,000 ($250,000 judgment plus interest) recovery is awarded without proof that Keeley (the insured) incurred economic loss, this Court will for the first time have departed from the principle of confining the damages for breach of contract by an insurer to the economic loss suffered by the promisee.

Id. at 560. "Upon adoption of the majority view," Justice Levin continued, "Counsel for plaintiffs could argue that Michigan no longer restricts plaintiffs claiming bad-faith settlement practices to recovery of pecuniary loss and has recognized a kind of hybrid cause of action sounding in contract, but actually allowing recover of losses akin to punitive damages." *Id.* at

563.[8]

Justice Levin concluded by proposing a "compromise" between the prepayment rule and the judgment rule: that the Court accept the essence of the judgment rule by eliminating the need to show partial payment, "but provide protection for insurers along the lines of the prepayment rule by precluding collection on the judgment from the insurer beyond what is or would actually be collectable from the insured." *Id.* at 565.

On rehearing, this Court went out of its way to adopt Justice Levin's dissenting opinion as its own. The Court had remanded the matter for a determination as to whether the insurer's bad faith had actually caused the excess judgment in that case. The trial court found that any acts of bad faith did not cause the excess judgment, and this Court agreed. The Court then recognized that, while it could simply vacate its original opinion on the basis of this finding, it would resolve the excess-judgment issue by adopting Justice Levin's dissent in the original *Keeley* opinion, which the Court found to represent the better measure of an insurer's liability when exhibiting bad faith that causes an excess judgment against its insured. *Keeley II*, at 436 Mich 375.

Thus, the following principles have been established in bad-faith failure to settle cases: (1) such cases only give rise to contract damages, not tort damages, *Keeley I,* at 433 Mich 556; (2) such damages are limited to the pecuniary loss actually suffered by the insured and are intended to place the insured in the same economic position the insured would have been in had

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[8] Justice Levin's observations about Michigan law concerning damages in breach of contract cases were grounded in longstanding caselaw. Where the evidence fails to establish that a plaintiff has suffered any damages as a result of the defendant's alleged breach of contract, the defendant is simply not liable. *Wright v Bateson,* 370 Mich 660, 667; 122 NW2d 683 (1963). Moreover, in order to be entitled to damages, the plaintiff bears the burden to prove that the alleged breach of contract caused ascertainable damages. *Walter Toebe and Co v Dep't of State Hwys,* 144 Mich App 21; 373 NW2d 233 (1985); *Wheelmakers, Inc v City of Flint,* 47 Mich App 434; 209 NW2d 444 (1973). See also *Kewin v Massachusetts Mut Life Ins Co*, 409 Mich 401; 295 NW2d 50 (1980).

there been no breach, *id.* at 557-562; and (3) the formality of payment or partial payment by the insured to the underlying plaintiff is not necessary. *Id.* Where it is shown in a particular failure to settle case that an insured has not incurred and will not in the future incur economic loss, such as an actual dollar judgment or a loss of credit, damages cannot be assessed against the insurer. *Id.*

Applying the principles established in *Keeley*, Citizens' insureds, the Farmer entities, cannot establish a bad-faith failure to settle claim against Citizens because—as the Court of Appeals acknowledged—they have not sustained and never will sustain economic harm as a result of the over-limits judgment. As the Court of Appeals correctly noted, the estate has released the Farmer entities from any obligation to pay the underlying judgment.[9] Under *Keeley,* that over-limits judgment thus cannot be an element of plaintiffs' damages because it is not a pecuniary loss that the Farmer entities suffered or potentially will suffer as a result of Citizens' alleged bad-faith failure to settle. To permit the over limits judgment to be an element of plaintiffs' claimed damages here would constitute a fraud because it would premise recovery on an untruth: that the Farmer entities are obligated to pay that over-limits judgment. It would also constitute an award of punitive damages, which *Keeley* expressly rejects. *Keeley I*, at 433 Mich 525.

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[9] The estate agreed that it would "forever forebear" from any action to collect the excess amount of the judgment from the Farmer entities. (Agreement at ¶10(b) and (f) as Exhibit C). By virtue of this Agreement, the Farmer entities have been completely relieved of their legal liability to satisfy the over-policy limits amount of the underlying judgment, as the Court of Appeals correctly found.

B. <u>The Court of Appeals' decision is erroneous and conflicts with *Keeley*</u>

The Court of Appeals correctly determined that the trial court's analysis did not support denial of summary disposition. Contrary to what the trial court appears to have found, the Court of Appeals recognized that the agreement between the estate and the Farmer entities "indisputably releases the Farmer parties from any obligation to pay the underlying judgment ...." (Slip Op, p 7). Indeed, the Court of Appeals agreed that Citizens' position is "an arguably correct interpretation of how *Keeley* might be applied to the circumstances presented in this case." (Slip Op, p 8). Nevertheless, the court rejected the argument, based solely on the court's perception that the result sought by Citizens is not in keeping with the purpose, or intent, of *Keeley*. Respectfully, the Court of Appeals' analysis does not withstand scrutiny: not only is Citizens' position consistent with the letter of *Keeley* (which the Court of Appeals appears to acknowledge), it is entirely consistent with the purpose and intent of *Keeley*. The Court of Appeals' opinion, on the other hand, conflicts with *Keeley*, and, therefore, merits review by this Court.

Justice Levin's concern with the view that was ultimately rejected by this Court was that, if it were adopted, "this Court will for the first time have departed from the principle of confining the damages for breach of contract by an insurer to the economic loss suffered by the promisee." *Keeley I* at 433 Mich 560. He also stated:

> Upon adoption of the majority view, counsel for plaintiff could argue that Michigan no longer restricts plaintiffs claiming bad faith settlement practices to recovery of pecuniary loss and has recognized a kind of hybrid cause of action sounding in contract, but actually allowing recovery of losses akin to punitive damages.

Id. at 563. If the Court of Appeals' opinion is allowed to stand, the change in Michigan law that concerned Justice Levin will have come to fruition. Despite the fact that Citizens' insured is completely insulated from ever suffering pecuniary loss at the hands of the over-limits judgment, under the Court of Appeals' opinion, the insured, or the insured's assignee, may still recover from Citizens.

A closer look at the Court of Appeals' analysis, in particular its attempts to explain and apply *Keeley,* reveals a number of errors that ultimately led to this erroneous conclusion. In declining to apply Citizens' "arguably correct interpretation," of how *Keeley* applies in this context, the court did not offer an alternative interpretation, or explanation, of how *Keeley* should be applied, except to explain that it believed Citizens' interpretation "is contrary to the purpose and intent of Justice Levin's dissent." (Slip Op, p 9). The Court of Appeals' opinion then discusses what the court believes to have been the intent behind Justice Levin's opinion, but it does not provide an analysis of the language used in *Keeley* that supports the conclusion it ultimately reached in this case. In other words, based strictly on the letter of *Keeley*, Citizens' position is the *only* correct interpretation of how *Keeley* might be applied to the circumstances presented in this case, and the Court of Appeals appears to have agreed, albeit without explicitly stating as much.

Moreover, the Court of Appeals' opinion that the result sought by Citizens is contrary to the purpose and intent of Justice Levin's dissent is simply not true. Rather, the Court of Appeals' opinion is contrary to the purpose and intent—as well as the letter—of Justice Levin's dissent. This is made manifest in a number of ways.

The principal reason given by the Court of Appeals to support its analysis is that it believed Citizens is attempting to turn what this Court intended to be a shield into a sword (Slip Op, p 8). After acknowledging that the *Keeley* decision provided a shield to guard insurers found liable for bad-faith failure to settle, the Court reasoned:

> Here, Citizens attempts to turn the shield provided in *Keeley* into a sword to escape any payment on an excess judgment, despite the insured's ability to pay some or all of it, merely because the insured assigned the bad faith claim to the judgment holder and in exchange obtained relief from paying the underlying judgment.

(Slip Op, p 8).

This statement is erroneous in two critical respects. First, the insured in this case *did not* assign the bad-faith claim to the judgment holder in exchange for relief from paying the underlying judgment. The insured did not assign the bad-faith claim to the estate until long after the estate had released the insured from any obligation to pay the underlying judgment. As set forth above in footnote three, the estate released the Farmer entities in the agreement, which is dated August 15, 1996. (See Exhibit C). The Farmer entities did not assign the bad-faith cause of action until the day before Citizens' original motion for summary disposition was heard, which was months later. The Court of Appeals acknowledged earlier in its opinion that the assignment of the bad-faith claim was not done contemporaneously with the agreement, but was done later. (Slip Op, p 2).[10]

Second, Citizens is not attempting to use a shield as a sword. It is attempting to use a shield as a shield. The Court of Appeals correctly recognized that Justice Levin intended to provide a shield to guard insurers found liable for bad-faith failure to settle. The purpose of that "shield" is to shield insurers from having to pay sums in a contract action to a promisee who has suffered no pecuniary loss. This is precisely what Citizens is arguing here: that the "shield"

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[10] In footnote two of its opinion, the Court of Appeals states that the assignment was made "pursuant to the terms and conditions of the agreement between the parties." The meaning of this clause is unclear, since there are no terms in the agreement that deal with the assignment or with the potential for an assignment. Rather, the agreement provided for a "joint lawsuit" brought against Citizens by both the Farmer entities and the estate as "an interested party." (See agreement, ¶ 10(c)).

intended for use by insurers found liable for bad-faith failure to settle in the absence of pecuniary loss by the insured be applied in this case, where there is a complete absence of pecuniary loss by the insured.

Nor is this just a matter of semantics. The Court of Appeals' analysis presumes that Justice Levin intended the no-pecuniary-loss shield to apply only in the context of solvency, i.e., where the insured's insulation against pecuniary loss is due to a lack of assets, and not in other contexts, such as where the insulation is due to an agreement by the judgment creditor not to collect the judgment. But there is simply no basis to assume that Justice Levin intended such a distinction to be drawn. To the contrary, there is every reason to believe that Justice Levin did not intend that the application of his approach should vary depending on the reason why the insured is prevented from suffering pecuniary loss. Justice Levin's criticism of Justice Archer's adoption of the judgment rule, which was stated repeatedly and in several different ways, was that it would allow recovery in a contract action without a showing of pecuniary loss, i.e., recovery based on something other than the objective of placing the insured in the same position economically that it would have been in had there been no failure to settle. The Court of Appeals' opinion is subject to the exact same criticisms that Justice Levin directed at Justice Archer's opinion, and the fact that the insured is insulated from suffering pecuniary loss because of a release, as opposed to insolvency, is entirely irrelevant.[11]

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[11] Even if the cause of the absence of pecuniary loss were relevant, there is simply no principled reason why a release voluntarily executed by the judgment creditor constitutes a less acceptable reason than insolvency. If anything, it is a *better* reason for a bad-faith failure to settle plaintiff not to be able to claim entitlement to damages from the insurer—particularly where the judgment creditor is proceeding with the claim by assignment from the insured—because the judgment creditor and insured exercise control over that situation, while presumably neither has the same level of control over the solvency of the insured.

That the Court of Appeals' opinion, and not Citizens' position, is contrary to the purpose and intent of Justice Levin's dissent is also made apparent in the analysis on page nine of the court's opinion. The court begins by correctly noting that, in *Keeley*, this Court sought to impart fairness and to find a balance between the two general approaches concerning the remedy for an insurer's bad-faith failure to settle. "By precluding collection on the judgment beyond what is or would be collectable from the insured," noted the Court of Appeals, "the Court prevents the third-party injured from collecting from the insured's insurer amounts which otherwise would not be collectable." (Slip Op, p 9). This statement is basically correct; Citizens would merely add that "the third-party injured" is not entitled to collect anything from the insured's insurer in the absence of an assignment—a bad-faith failure to settle action belongs to an insured and to an insured alone. It is at this point that the Court of Appeals takes a wrong turn. The court begins by stating:

> Citizens seeks to limit collection to "what is or would actually be collectable from the insured," *Keeley I, supra*, without regard to the Court's analysis in arriving at this conclusion. Read in its entirety, the *Keeley* decision is concerned with how much is or would be collectable from the insured to limit the insurer's liability in a fair manner.

(Slip Op, p 9).

This statement is flawed in that, respectfully, it is the Court of Appeals, not Citizens, that has disregarded this Court's analysis in arriving at its conclusion in *Keeley.* The *Keeley* decision is concerned not so much "with how much is or would be collectable from the insured to limit the insurer's liability in a fair manner." It is concerned primarily with (1) whether recovery in a bad-faith failure to settle case is limited to the pecuniary loss actually suffered by the insured, and, if so, (2) whether actual collection from an insured is necessitated by the fact that without it, the insured will have sustained no pecuniary loss, and, therefore, technically would have no cause of action for a bad-faith failure to settle against its insurer. By adopting Justice Levin's dissent, the Court held that, while it would not require the formality of actual collection, recovery is otherwise limited to the pecuniary loss actually suffered by the insured.

Neither Justice Levin nor the Court in adopting Justice Levin's opinion suggested that, other than excusing the formality of prepayment, Michigan was dispensing with the requirement—in any context—that there be a showing of actual pecuniary loss on the part of an insured before there can be a recovery from the insurer. To the contrary, the fundamental point of Justice Levin's opinion was to emphasize the importance of this requirement, and to note that Justice Archer's approach would have the effect of discarding it—and would be the first Michigan case to do so. It was only after stressing the requirement of a showing of pecuniary loss that Justice Levin concluded that the Court should "provide protection for insurers along the lines of the prepayment rule" by disallowing collection from the insurer "beyond what is or would actually be collectable from the insured." Thus, contrary to the Court of Appeals' belief that Citizens' position in this case disregards this Court's analysis in arriving at its ultimate conclusion, in fact, Citizens' position is based every bit as much on the Court's analysis as it is on its conclusion.

The Court of Appeals' opinion, on the other hand, is inconsistent not only with the ultimate conclusion in *Keeley*, but with the Court's analysis as well. Indeed, the Court of Appeals' opinion does precisely what Justice Archer's opinion would have done, as Justice Levin warned: by holding that plaintiffs are entitled to collect from Citizens despite the existence of a release preventing the Citizens' insured from ever suffering pecuniary loss, *it dispenses with the requirement of a showing of pecuniary loss on the part of the insured.*

The balance of the Court of Appeals' analysis on page nine of its opinion further demonstrates both error and inconsistency with *Keeley*. In addition to his concern that Justice Archer's opinion allowed recovery without a showing of pecuniary loss, Justice Levin expressed concern that Justice Archer had incorrectly focused on the manner in which the insurer would be impacted if the judgment rule approach were not adopted.[12] As Justice Levin recognized, "There should not be any concern about a so-called windfall to an insurer. Contract damages are generally measured by the loss to the promisee, not the loss or gain to some other person." *Keeley I*, at 433 Mich 559. Contrary to Justice Levin's instruction that a court should not concern itself with whether an insurer is obtaining a windfall, the Court of Appeals did exactly that in this case. After previously stating (incorrectly) that Citizens is attempting to turn a shield into a sword, the Court of Appeals said it was not "persuaded by Citizens' vision of eluding payment ..."; that to rule in Citizens' favor "would be to evade the intent of our Supreme Court and cause a windfall for the insurer on the basis of the insured's savvy in saving itself from financial ruin"; and that an insurer should not "benefit from its insured's maneuverings to protect itself." (Slip Op, p 9). The Court of Appeals' focus in this regard subjects its opinion to the exact same criticisms that were made by Justice Levin about Justice Archer's opinion.

In addition to focusing improperly on a perceived "windfall" to the insurer, the Court of Appeals appears to have incorrectly surmised that the insured would somehow be "penalized" by the dismissal of its bad-faith failure to settle claim. The court reasoned:

> We cannot conclude, as Citizens suggests, that the fact that the Farmer parties have entered an agreement to prevent financial ruin they resultantly caused the forfeiture of any recovery from Citizens for its alleged bad faith. ... An insured should not be penalized for devising or taking advantage of a method of avoiding financial loss allegedly flowing from the bad faith of its insurer, nor should an insurer benefit from its insured's maneuverings to protect itself.

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[12] As Justice Levin stated, Justice Archer's opinion was based on the rationale that it would "underscore our serious concern with bad-faith practices in the insurance industry." *Keeley I,* at 556 (citing Justice Archer's opinion). Justice Levin quoted several other portions of Justice Archer's opinion along the same lines, including the statement that the rule that that opinion would adopt "eliminates the insurer's ability to hide behind the financial status of its insured." (*Id.*, fn 18 (*Keeley I*, Justice Levin quoting Justice Archer's opinion).

(Slip Op, p 9).[13] Respectfully, this analysis is clearly inconsistent with Justice Levin's opinion, in particular his emphasis that the objective of a bad-faith failure to settle claim is to put the insured in the same economic position that the insured would have been in had there been no breach. The fact that the Farmer parties were able to secure a release from the estate without contemporaneously assigning the bad-faith claim to the estate clearly does cause a forfeiture of any recovery from Citizens—because there is no pecuniary loss to reimburse. The Farmer entities are already in the same economic position in which they would have been had there been no alleged bad-faith breach. For the same reason, there is no basis to suggest that the Farmer entities have been "penalized."

In its footnote 11, the Court of Appeals stated that it believes its interpretation "of the *Keeley* Court's policy decision" is supported by Justice Levin's reference in a footnote to Judge Keeton's comment on the extent of liability in this context. In that comment, Judge Keeton expressed that "[i]t should be possible to formulate a workable doctrine (1) that fully protects the insured from loss, (2) that does not result in eliminating the 'penalty' on the insurer, and (3) that does not produce a 'windfall' for the third party claimant." (Slip Op, p 9, n 11 (quoting Judge Keeton's comment as it appears in *Keeley I*, at 433 Mich 562, n27)). Respectfully, the Court of Appeals' opinion is not supported by that comment. The reason a "workable doctrine" was needed in the context of *Keeley* (and in the context of Judge Keeton's comment) is because of the conceptual difficulty posed by the fact that the objective in a failure to settle case, which is to

[13] The court also stated that it believed this Court "did not nor did it intend to, preclude recovery against an insurer for bad faith failure to settle simply because the insured takes steps to protect itself from an excess judgment that it believes resulted from its insurer's bad faith failure to settle." (Slip Op, p 10).

make the insured whole economically, is essentially illusory unless and until the judgment has actually been collected against the insured. The "workable doctrine" proposed by Judge Keeton consists of:

> [p]ermitting a single recovery against the insurer on the excess liability claim, at the instance of either the insured or the third party claimant [in the event of an assignment], in an amount equal to the insured's net assets which are not exempt from legal process, and holding that the claimant's tort judgment against the insured is fully discharged by payment of this sum to the claimant either by the insured or by the insurer on the insured's behalf.

Keeley I, at 433 Mich 565, n27 (citing Judge Keeton's comment)).

That "workable doctrine" is what Justice Levin's decision adopted, i.e., an insured (or an underlying plaintiff, if there has been an assignment) need not show that the insured has paid the judgment, but is entitled to collect from the insurer insofar as the judgment "is or would *actually* be collectable from the insured." *Keeley I*, at 433 Mich 564 (emphasis added). Applying this already-created workable doctrine to the facts of the instant case, there is no basis for any recovery because no amount "is or would actually be collectable from the [Farmer entities]."[14]

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[14] In the text immediately preceding its footnote 11, the Court of Appeals, after expressing concern about the insurer receiving a windfall, noted that the insured's savvy in protecting itself from the judgment "needed to be done only as a result of the insurer's alleged bad faith in causing an excess judgment against its insured." This statement incorrectly implies innocence on the part of the insured. As Judge Keeton observed in the "workable doctrine" comment referenced by the Court of Appeals, the insured should not be heard to complain in this context (of a loss of privacy due to having to disclose assets) since the insured has "committ[ed] a tort against the claimant that caused damages of such severity that the limited amount of liability insurance coverage, chosen by the insured, was inadequate." *Keeley I,* at 433 Mich 564, n27 (quoting Judge Keeton). That, too, necessitated the insured's savvy in protecting itself. In any event, because the objective of a recovery in this case is simply to make the Farmer entities whole economically, the Court of Appeals' assignment of blame to Citizens, like its concern about a "windfall" to Citizens, is misplaced.

Insofar as the Court of Appeals was suggesting in its footnote 11 that the estate and the Farmer entities had entered into a workable *arrangement* that allows recovery notwithstanding *Keeley*, the court erred for the reasons discussed above. At the same time, it was certainly possible for the estate and the Farmer entities to enter into an arrangement that would have protected the Farmer entities' right to proceed against Citizens. The easiest way would have been for the estate to have agreed simply to hold off on executing on the judgment while the parties proceeded with a joint lawsuit against Citizens, while not waiving its right to collect the judgment in the future. This is what was done in *Keeley.*[15] Even if the estate had received an assignment of the bad-faith cause of action against Citizens from the Farmer entities in exchange for an agreement not to execute on the judgment, the plaintiffs could have at least argued that there was potential for pecuniary loss on the part of the insured under *Keeley* inasmuch as they were exposed to potential collection of the judgment up until the time the cause of action was assigned. But the parties did neither. Instead, the parties agreed that there would be no assignment, i.e., the parties would proceed with a joint lawsuit, while, at the same time, the estate agreed never to execute on the judgment.

The clear intent of the parties' agreement was to eliminate any possibility that the Farmer entities would suffer pecuniary harm at the hands of the over-limits judgment. As the Court of

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[15] Plaintiffs argued to the Court of Appeals that their agreement was similar to the agreement used by the insured and judgment creditor in *Keeley*, which plaintiffs attached to their lower court filings in this case. But it is undisputed that the agreement in the instant case differs in at least one critical respect. The original draft of the agreement, like the agreement plaintiffs contend was used in *Keeley*, stated that the estate would "forebear" from executing. The agreement was subsequently changed, at the insistence of the Farmer entities' attorney, to provide that the estate would "forever forebear" from executing on the judgment. (See deposition of Robert Pollice, attorney for the Farmer entities, pp 54-57, 61, attached as Exhibit E). Both parties to the agreement testified that it was their intent that the Farmer entities were being released from ever having to pay the over-limits amount. (See deposition of Johnny Farmer, p 28, attached as Exhibit F; and deposition of James Riley, pp 21-22, attached as Exhibit G).

Appeals noted, this agreement does appear, on its face, to reflect "savvy" on the part of the insured. But regardless of what might have motivated the estate to release the insured without receiving an assignment, the effect of that agreement under *Keeley* is that the Farmer entities may not collect from Citizens under a theory of bad-faith failure to settle because it eliminated the possibility that the Farmer entities would sustain pecuniary loss. More importantly for present purposes, the Court of Appeals' conclusion to the contrary cannot be reconciled with *Keeley*.

Finally, the flawed nature of the Court of Appeals' analysis is revealed in the court's attempted application of the *Keeley* holding on page 10 of its opinion. The opinion concludes by stating that, should the trial court determine that Citizens engaged in a bad-faith failure to settle, it "shall preclude 'collection on the judgment from Citizens beyond what is or would actually be collectable from the Farmer Parties.'" (Slip Op, p 10 (quoting *Keeley I* at 565)). The phrase "what is [collectable]" does not have any purpose in that sentence because nothing "is" collectable from the Farmer Parties. By the phrase "would actually be collectable," the Court of Appeals means what would actually be collectable but for the release making all of the judgment *un*collectable. The meaning of the court's sentence would be unaffected if the words "is or" were removed, and the clause was just "what would actually be collectable." By contrast, both phrases, "what is" and "would actually be collectable," have a clear purpose in Justice Levin's opinion. "What is" collectable refers to amounts that could be collected given an insured's existing assets; what "would actually be collectable" refers to the insured's prospects of attaining in the future assests from which the judgment could be collected. *Keeley I* at 433 Mich 564-565. The use of the word "actually" further reinforces Justice Levin's intent that collectability of the judgment must be actual, not theoretical.

Ultimately, the Court of Appeals' opinion simply cannot be reconciled with *Keeley*, whether the focus is on the actual holding of *Keeley* or on the "purpose and intent" of Justice Levin's opinion. Reduced to its essence, the Court of Appeals' opinion (1) assumes, without citing any basis for the assumption, that Justice Levin intended the no-pecuniary-loss rule (or "shield" as the Court of Appeals put it) to protect insurers only when the reason for the absence of pecuniary loss is insolvency; (2) cites the avoidance of a perceived "windfall" to the insurer as a, if not the, primary basis for its conclusion—in direct contravention of the instruction in *Keeley* that that is not to be a factor;[16] and (3) concludes that an insured need not sustain pecuniary loss or be exposed to pecuniary loss in order to proceed with a bad-faith failure to settle claim against its insured—again, in direct contravention of *Keeley*. In reaching this result, the Court of Appeals refused to apply what it acknowledged to be a correct interpretaion of *Keeley*, and cited no authority from any jurisdiction to support its holding—a holding that is contrary to decisions reached by numerous other courts that have decided the same or similar issues, as discussed below.

Because it conflicts with *Keeley*, this Court should either peremptorily reverse the Court of Appeals' opinion, or, at a minimum, review it.

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[16] The ironic effect of these first two aspects of the Court of Appeals' opinion is that, while presumably acknowledging that an insurer is permitted to receive a "windfall" if its insured is insolvent, the court holds that the insurer must not be permitted to receive one if the insured is solvent but is willing to arrange with another to foist a judgment on the insurer in order to protect itself—reasoning that this is what Justice Levin intended.

C. **The Court of Appeals' opinion conflicts with decisions from jurisdictions that have addressed this or similar issues.**

Courts in a number of jurisdictions have addressed the specific issue of whether a release or a covenant not to execute in this context defeats a bad-faith failure to settle claim, and have held that it does. For example, in *Clement v Prudential Property & Cas Ins Co,* 790 F2d 1545, 1548 (CA 11, 1986), the Eleventh Circuit applying Florida law succinctly observed:

> [I]f an insured is no longer exposed to any loss in excess of the limits of his liability insurance policy, he no longer has any claim he might previously have had against his insurance company for bad faith failure to settle within policy limits. Thus if an injured third party releases the insured from liability, any bad faith claim then retained by the insured arising out of his liability to the injured third party ceases to exist, because the insured is no longer exposed to any excess damages. In this case the settlement agreement assured appellant that he would not be held liable personally for the excess judgment to which he agreed.

(Emphasis added). The Eleventh Circuit further noted that under Florida law (which is virtually identical to Michigan law with respect to the assignment of a bad-faith claim), "in the absence of a prior assignment of the bad faith claim, no such claim remains after the insured is released from liability for damages he otherwise might have suffered as a result of the insurer's bad faith." *Id.*

The same result was reached in *Willcox v American Home Assur Co,* 900 F Supp 850, 857 (SD Tex 1995). In that case the insured, a law firm, was released from attempted execution on a $10,000,000 judgment against it by the injured party, the Willcoxes. In exchange, the law firm assigned to the Willcoxes the right to proceed against its insurer under a theory of bad-faith refusal to settle. The court held that the agreement not to collect against the insured barred a claim against the insurer, by either the insured or its assignee, for damages in excess of the policy limits. Citing a prior decision from a Texas state court, the court reasoned:

> To recover more than the policy limits from the insurer, the judgment creditor must assert the insured's injury. If the judgment cannot be enforced against the insured, no such injury exists. The insured may assign to his judgment creditor any claim he has against his insurer for payment of the excess award, but such assigned claim is actionable only as long as the insured remains liable for the excess damages. To allow the creditor to release the insured from liability for such excess damages without effecting the release of the insurer would give the creditor and insure the power unilaterally to extend the insurer's liability. This would defeat, not serve, public policy.

Id at 857 (citation omitted). See also *Romstadt v Allstate Ins Co,* 844 F Supp 361, 365-67 (ND Ohio 1994) (insurer cannot be held liable for excess judgment if the insured received assurance not to collect by the judgment creditor).

In *In Re Tutu Water Wells Contamination Litigation*, 78 F Supp 2d 423 (DVI 1999), the court addressed a scenario similar to the case at bar. In that case, Texaco agreed not to execute on a $16,828,392 judgment it possessed against Morgan, who was insured by CIGNA. In exchange, Morgan agreed to assign to Texaco all claims that Morgan had against CIGNA or other insurance carriers. Thereafter, Texaco sought to collect the judgment against CIGNA as Morgan's assignee. In opposing that claim, CIGNA argued that Texaco was not entitled to recover damages in excess of the policy limits under a bad-faith breach theory because Morgan was never actually obligated to satisfy an excess verdict, and, in fact, never could be so obligated because of the agreement not to execute given Morgan by Texaco. *Id* at 427.

The district court found that the question of whether an insurer can be held liable in excess of policy limits under such an arrangement represented a matter of first impression for that court. *Id* at 432. The court proceeded to undertake a detailed analysis of the issue, including a comprehensive discussion of the cases addressing the issue in the United States. After doing so, the court held that Texaco's entitlement to damages was limited to the extent of coverage provided by the policy issued by CIGNA. *Id* at 433. The court relied upon the reasoning set forth in *Willcox, supra*, that "to recover more than the policy limits from the insurer, the judgment creditor must assert the insured's injury. If the judgment cannot be enforced against the insured, no such injury exists." *In Re Tutu*, *supra,* at 423 (citations omitted). The court also noted that the reasoning of *Willcox, supra,* had been adopted and applied by other courts. The *Tutu* court reasoned:

> While the available authority is limited, it nonetheless expresses a clear intent that the type of judgment involved in the instant matter should not be enforced in excess of policy limits. Thus, it appears that Texaco is asking the Court to adopt a position that is contrary to the relevant caselaw.
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> * * *
>
> [F]or all intents and purposes, the covenant operated as a release and Morgan was never actually damaged by the $16,683,392 judgment he consented to. Therefore the Court concludes that, like the plaintiff in *Willcox*, Morgan never suffered an actual injury in excess of his coverage limits and therefore the plaintiff is precluded from seeking redress from CIGNA for amounts in excess of the policy.

Id at 432-434.

In *Hamilton v Maryland Cas Co*, 117 Cal Rptr 2d 318 (2002), also a bad-faith failure to settle case, the Supreme Court of California ruled that an insurer cannot be bound by a settlement made without its participation and "without any actual commitment on its insured's part to pay the judgment, even where the settlement has been found to be in good faith." *Id* at 327. As the court in that case put it, the defendant insurer could not be required to pay the over-limits judgment where, among other factors, "plaintiffs cannot show [that the insured] suffered any damages as a result of Maryland's alleged breach." *Id* at 328.

Also instructive is *Johnson v Acceptance Ins Co*, 292 F Supp 2d 857 (ND W Virg, 2003), which was decided after the instant case was argued in the Court of Appeals. In that case, the underlying plaintiff, who had obtained a judgment of $2.2 million against BHA, agreed not to execute against BHA in exchange for an assignment of all of BHA's rights against its insurer, who had refused to defend BHA. Relying on *In re Tutu, supra, Willcox, supra,* and other similar authorities, the court held that the underlying plaintiff was precluded from recovering any amount over BHA's policy limits. *Id* at 867.

All of these cases, which, except *Johnson,* were cited by Citizens in its appellate briefing, further support that the Court of Appeals' decision is wrong and should be reviewed by this Court. It is undisputed that the Farmer entities have suffered no damages because the estate has conclusively agreed not to hold them liable for that portion of the judgment that exceeds the policy limits.

Moreover, since the Farmer entities failed to assign their bad-faith cause of action to the estate before obtaining the estate's release, any bad-faith claim against Citizens was extinguished upon execution of the Agreement between the estate and the Farmer Bros. entities on or about August 8, 1996. In fact, the failure to assign the cause of action to the estate in connection with the release makes the relief requested by Citizens even more appropriate than the relief requested by the insurers in *Hamilton*, *Willcox, In Re Tutu, and Johnson*. In each of those cases the insured had assigned its right to proceed with a bad-faith cause of action to the underlying plaintiff in exchange for a conventional agreement not to execute. Notwithstanding such assignments, the court in each case found the agreement not to execute controlling. The pivotal fact, according to the courts, was that the insured was never actually damaged by the judgment; the insured never suffered an actual injury that could be the subject of recovery on the bad-faith claim assigned to the judgment creditor. In the instant case, not only were the Farmer entities never damaged, the bad-faith claim was not even assigned to the estate in exchange for the release.

The decisions cited above align precisely with the analysis adopted by this Court in *Keeley, supra.* Treated as a contract action, as it must be under *Keeley*, the instant failure to settle case cannot succeed because the insureds have not suffered damages that can be awarded in a contract action. The Farmer entities simply have not suffered and will not suffer any cognizable damages as a result of Citizens' alleged wrongful refusal to settle, and, therefore, neither they nor their assignees can recover in this action. This Court should peremptorily reverse, or, at a minimum, review the contrary conclusion reached by the Court of Appeals.

D. <u>This case involves legal principles of major significance to the state's jurisprudence.</u>

The Court of Appeals' opinion effectively casts aside the requirement of showing pecuniary loss as a precondition of recovery in a contract action. Further, it allows recovery notwithstanding the absence of pecuniary loss, holding essentially that such recovery can be measured by the amount that would have represented the pecuniary loss but for the promisee's total mitigation of that loss. The significance of the Court of Appeals' decision, should it stand, is considerable, and will be manifested in at least two areas of Michigan jurisprudence.

The first is in the context of contract litigation generally. A plaintiff in a contract action who has suffered no pecuniary loss as a result of the breach can now argue, citing the Court of Appeals' opinion, that he is nonetheless entitled to recover. So long as the plaintiff can convince a court that there is a good reason why the promisor should have to pay damages, including avoiding a windfall on the part of the promisor, the Court of Appeals' opinion would support recovery.

Whereas it might be argued that the Court of Appeals' opinion should be limited to the context of bad-faith failure to settle cases, the fact remains that such claims are contract claims, and the Court of Appeals' opinion represents a significant departure from long-standing law regarding the nature of damages in contract claims. In writing his opinion in *Keeley,* Justice

Levin expressed concern that Justice Archer's opinion, though it was in the context of a bad-faith failure to settle case, represented a departure from prior Michigan law in the area of contract litigation, specifically the basis for measuring damages. As noted above in argument section B., the change in Michigan contract law that Justice Levin's opinion portended, though it was avoided when this Court rejected Justice Archer's opinion, has now come to pass in the Court of Appeals' opinion.

Secondly, even if the effect of the Court of Appeals' opinion could somehow be circumscribed, and its holding limited to the context of bad-faith failure to settle cases, the impact will still be significant. There is fairly little caselaw from this Court and the Court of Appeals in this area. *Keeley* has provided important guidance to litigants in this area regarding the nature of such claims, in particular by establishing rules defining the parameters for recovery. While Citizens submits that the Court of Appeals' opinion conflicts with *Keeley* as argued above, at a minimum, it modifies substantially the rules set forth in *Keeley*, reaching a conclusion that is directly contrary to the holdings of a number of courts that have decided the same issue. And it does so without relying upon any authority from any jurisdiction to support its conclusion. The Court of Appeals' improper extension of *Keeley* is likely to erode the helpful direction that *Keeley* has provided litigants in this area for nearly 15 years.

Perhaps more importantly, the opinion opens the door for potential abuse by insureds and claimants. Armed with the Court of Appeals' decision, litigants now appear to be free to stipulate to a judgment in whatever amount they desire in order to seek collection from the insurer of that amount, while the claimant agrees not to execute against the insured. There is no holding or discussion in the Court of Appeals' opinion that would prevent such activity. In fact, the Court of Appeals specifically stated that an insured's maneuverings to avoid exposure to a judgment do not affect a bad-faith failure to settle claim against its insurer (Slip Op., p 9).

Presumably such "maneuverings" will lead to a substantial increase in such stipulated judgments. Faced with the prospect of litigating a case that could result in a judgment over limits, an insured would be wise to stipulate to any judgment requested by plaintiff if, by doing so in exchange for the claimant's agreement not to execute, the insured can avoid exposure to the over-limits amount.

If this Court does not peremptorily reverse the Court of Appeals' opinion for reasons set forth above, because the Court of Appeals' opinion raises issues of major significance to the state's jurisprudence, this Court should grant leave to appeal.

RELIEF

For the reasons set forth above, Defendant-appellant Citizens first and foremost asks that this Court peremptorily reverse the Court of Appeals' opinion, and remand the matter to the trial court for entry of summary disposition in favor of Citizens. Failing that, Citizens asks that the Court grant leave to appeal the complained-of opinion. Citizens further requests any and all other relief to which it is entitled in equity and law.

Respectfully submitted,

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